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PAGE 01 ROME 08866 01 OF 02 261954Z

63

ACTION EUR-25

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PAGE 02 ROME 08866 01 OF 02 261954Z

C O N F I D E N T I A L SECTION 1 OF 2 ROME 8866

E.O. 11652: GDS

TAGS: PFOR, PINT, IT

SUBJECT: ITALY: POLITICAL AND ECONOMIC TRENDS

REF: ROME 4065

1. SUMMARY: ITALIAN POLITICAL AND ECONOMIC BALANCES ARE MARKEDLY MORE FRAGILE FOLLOWING THE BITTERLY CONTESTED DIVORCE REFERENDUM, THE REGIONAL ELECTIONS IN SARDINIA, AND THE HARD-BARGAINED ECONOMIC ACCORDS WHICH HAVE PERMITTED THE 5TH ROMOR GOVERNMENT TO CONTINUE. ALTHOUGH ITALIAN PRODUCTION LEVELS AND EMPLOYMENT ARE HIGHT, AND BUSINESS IS PROFITABLE, THERE ARE QUESTIONS AS TO WHETHER THE AGREED ECONOMIC STABILIZATION PACKAGE WILL BE EFFECTIVE AND SUFFICIENT. THE FUTURE OF THE PRESENT GOVERNMENT WILL DEPEND LARGELY UPON ECONOMIC PERFORMANCE BETWEEN NOW AND AUTUMN. PARTICULARLY SIGNIFICANT, INT EH EXPECTED GOVERNMENTAL REVIEW OF THE SITUATION AT THE SUMMER'S END, WILL BE THE SHAKEN CONFIDENCE OF THE DC AND THE WEAKENED POSITION OF FANFANI, THE DC LEADER, AS WELL AS THE MORE AGGRESSIVE POSITION OF THE SOCIALISTS, RIDING HIGH ON THE WAVE OF THE PRO-DIVORCE WIN AND PSI GAINS IN THE SARDINIAN ELECTIONS. IN FOREIGN AFFAIRS THE EMBASSY SEES SOME LESSENING OF U.S. PROBLEMS WITH ITALY IN MULTILATERAL FORA, BUT A LIKELIHOOD THAT DIFFICULTIES RELATING TO THE HOME PORTING OF THE SUBMARINE TENDER AT LA MADDELENA WILL CONTINUE.

END SUMMARY.

2. ECONOMIC. THE OVERRIDING QUESTION NOW BEFORE THE COUNTRY IS WHETHER THE ECONOMIC STAILIZATION PACKAGE AGREED BETWEEN THE COALITION PARTIES JUNE 18 WILL BE EFFECTIVE. THERE ARE TWO MAJOR ELEMENTS TO BE CONSIDERED:

A. WHETHER THE PROGRAM AS FRAMED IS SUFFICIENTLY RIGOROUS TO MODERATE INFLATION (NOW AROUND 20 PERCENT ON AN ANNUAL BASIS) AND EVENTUALLY REDUCE THE MASSIVE AND UNSUSTAINABLE BALANCE OF PAYMENTS DEFICIT. NO CLEAR ANSWER IS AVAILABLE AT THIS POINT: CONSERVATIVE ELEMENTS TEND TO DESCRIBE THE PROGRAM AS TOO LAX, WHILE THE LEFT BELIEVES IT WILL REDUCE WORKER CONSUMPTION TOO MUCH WITHOUT HALTING INFLATION. ONE MISSING ELEMENT IS WHETHER

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PAGE 03 ROME 08866 01 OF 02 261954Z

AND TO WHAT EXTENT THE LIRA WILL BE ALLOWED TO DEPRECIATE. A DEPRECIATION OF THE ORDER OF 10 PERCENT IS PROBABLY NECESSARY FOR A WORKABLE PROGRAM, BUT WILL BE POLITICALLY UNPOPULAR, PARTICULARLY WITH THE LEFT, AND WILL QUICKLY BE TRANSLATED INTO A GENERAL INCREASE I PRICE.

B. WHETHER IT CAN BE IMPLEMENTED. ALTHOUGH THE PARTIES HAVE AGREED ON THE PROGRAM, AND SOME UNION LEADERSHIP IS COMMITTED

TO ACCEPT IT, IT IS UNCERTAIN, PARTICULARLY IF INFLATION CONTINUES AT PRESENT RATES, WHETHER THE UNIONS AS A WHOLE AND ESPECIALLY THE UNION RANK AND FILE WILL DO SO. PRESSURES FOR GOVERNMENT SPENDING -- TO RESCUE BANKRUPT MUNICIPALITIES AND THE HOSPITAL SYSTEM, FOR EXAMPLE -- WILL BE ENORMOUS. THERE ARE DOUBTS THAT THE GOVERNMENT WILL BE RESOLUTE ENOUGH TO REACH ITS REVENUE TARGETS, WHILE THE REQUIREMENTS FOR AND AVAILABILITY OF TRANSITIONAL FOREIGN ASSISTANCE ARE STILL AN UNEXPLORED FACTOR.

THUS WHILE AGREEMENT ON THE PROGRAM WAS AN ESSENTIAL STEP TO AVOID ECONOMIC COLLAPSE (WITH CONSEQUENCES FOR ITALY'S MAJOR ECONOMIC PARTNERS AS WELL AS ITALY) AND IS A POSITIVE ELEMENT, MANY QUESTIONS REMAIN. CONFIDENCE HAS NOT YET BEEN RESTORED.

3. ON THE OTHER HAND, INFLATION ASIDE, ITALY IS PROSPEROUS AND GROWING. PRODUCTION IS AT RECORD LEVELS IN MOST INDUSTRIAL SECTORS, EMPLOYMENT IS HIGH AND BUSINESS IS PROFITABLE. IF THE STABILIZATION PROGRAM SUCCEEDS IN MAINTAINING THIS HIGH LEVEL OF ECONOMIC ACTIVITY AND PUTTING IT ON A SUSTAINABLE BASIS, ITALY SHOULD SHOW GOOD GROWTH -- PERHAPS 5 PERCENT IN 1974 -- WITH REASONABLE PROSPECTS FOR CONTINUATION IN 1975. THE GRADUAL REDUCTION IN WORLD RAW MATERIAL PRICES NOW UNDER WAY WILL HELP, JUST AS THE SHARP INCREASES IN 1973 WERE SEVERELY DAMAGING

THE ENERGY DEFICIT WILL REMAIN A MOST DIFFICULT PROBLEM AND ITALY WILL NEED INTERNATIONAL ASSISTANCE TO FINANCE IT.

4. LABOR: THE FEDERATION CGIL, CISL, UIL (CCU) IS TAKING A CAUTIOUS ATTITUDE TOWARD THE NEW GOVERNMENT ECONOMIC ACCORDS. LABOR FEARS THAT MAJOR INCREASES IN UNEMPLOYMENT WILL RESULT FROM THE MEASURES BEING INSTITUTED. THE CONFEDERATIONS MUST FEEL THEIR WAY, RECOGNIZING THAT THEY MAY CONTINUE TO EXPERIENCE

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PAGE 04 ROME 08866 01 OF 02 261954Z

DIFFICULTY IN CONTROLLING THE TRUCULENCE OF THEIR CONSTITUTENT UNIONS, PARTICULARLY THOSE IN THE METAL TRADES.

IN OTHER LABOR AREAS, HOWEVER, DEVELOPMENTS HAVE BEEN MORE CLEAR. THESE DEVELOPMENTS ARE:

A. THE UNIFICATION TREATY HAS BEEN SLOWED, THOUGH NOT REVERSED, AS A RESULT OF POLITICAL DIVISIONS INDUCED BY THE DIVORCE REFERENDUM AND THE INSTABILITY OF THE CENTER-LEFT COALITION, AND BY THE BRIEF CGIL CAMPAIGN, NOW ABATED, TO GAIN A SHARE OF GOVERNMENTAL POWER FOR THE PCI. THIS HAS LED TO SOME SECOND THOUGHTS AT CISL, AND HAS GIVEN RISE TO INCREASED INTERNAL STRAINS IN THE UIL.

B. COLLECTIVE CONTRACTS HAVE DEVELOPED A PATTERN OF INCORPORATING

COMMITMENTS FOR SOCIAL ENDS, SUCH AS INVESTMENTS IN THE SOUTH.

C. ADDITIONALLY, THERE IS A TREND TOWARD DEMANDING AND RECEIVING FLAT SUM WAGE INCREASES INDENTICAL FOR ALL, WITH THE CONSEQUENT TENDENCY TOWARD A LESSENING OF THE DIFFERENCES IN THE INCOME OF DIFFERING JOB CATEGORIES.

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PAGE 01 ROME 08866 02 OF 02 262014Z

63

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PAGE 02 ROME 08866 02 OF 02 262014Z

C O N F I D E N T I A L SECTION 2 OF 2 ROME 8866

5. POLITICAL - INTERNAL AND FOREIGN AFFAIRS: DURING THE SECOND CALENDAR QUARTER, THE DIVORCE REFERENDUM AND THE CRITICAL NEED FOR ECONOMIC RESTRAINTS CREATED EXCEPTIONAL STRAINS WITHIN THE COALITION. THE RESULT HAS BEEN TO INCREASE THE TREND TOWARD EROSION OF CONFIDENCE AND COMPACTNESS WITHIN THE GOVERNING MAJORITY. THE COALITION HAS BEEN PASTED TOGETHER SUFFICIENTLY TO LAST, WITH ONLY A MODICUM OF GOOD LUCK, THROUGH THE SUMMER, BUT ITS FUTURE SUCCESS WILL DEPEND VERY MUCH ON THE ECONOMIC QUESTIONS STILL UNRESOLVED.

6. CONTRARY TO THE EXPECTATIONS OF MOST, THE DIVORCE REFERENDUM SHOWED A 3 TO 2 MARGIN IN FAVOR OF DIVORCE. THIS OUTCOME, AND THE SIZE OF THE PRO-DIVORCE WIN, WERE BOTH A SURPRISE AND A BLOW TO DC LEADER FANFANI AND THE PARTY. IN CONSEQUENCE, FERMENT, INSECURITY, AND CRITICISM OF FANFANI ARE GROWING WITHIN THE PARTY, BUT GIVEN FANFANI'S RESILIENCE, HE CANNOT BE COUNTED OUT. DC PROBLEMS ARE AGGRAVATED BY THE FACT THAT THE SOCIALISTS (PSI) WERE GREATLY STIMULATED BY THE PRO-DIVORCE WIN, AND HAVE TAKEN A STANCE BASED ON THE ASSUMPTION THAT THE REFERENDUM RESULTS INDICATE A NEW BASIC BALANCE OF POLITICAL FORCES WITHIN THE COUNTRY. THE PSI VIEW WAS REINFORCED BY THE RESULTS OF THE RECENT SARDINIAN REGIONAL ELECTIONS, IN WHICH THE PSI WAS A BIG WINNER WHILE THE DC SUFFERED SIGNIFICANT LOSSES. SOCIALIST BARGAINING IN THE INTRA-GOVERNMENTAL NEGOTIATION OF THE CREDIT AND FISCAL POLICY AGREEMENT OF JUNE 18 WAS WITHOUT DOUBT TOUGHER AS A RESULT OF THESE TWO ELECTORAL TESTS. MOREOVER, IT IS NO SECRET THAT THE SOCIALISTS INTEND TO U THEIR PRICE FOR PARTICIPATION IN THE GOVERNMENT AT THE FIRST CONVENIENT OCCASION. THE PSI INTENDS TO PUSH FOR ONE OR MORE OF THE IMPORTANT MINISTRIES PREVIOUSLY DENIED THEM. THESE INCLUDE: DEFENSE, INTERIOR, AND TREASURY.

7. BOTH THE REFERENDUM AND THE VERY LIMITED SAMPLING OF THE ELECTORATE INVOLVED IN THE SARDINIAN REGIONAL ELECTIONS FLAGGED A TREND IN ITALY EVEN MORE IMPORTANT THAN THE IMMEDIATE EFFECTS
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PAGE 03 ROME 08866 02 OF 02 262014Z

ON THE DC, THE PSI, AND THEIR COOPERATION IN THE CURRENT COALITION. THE REFERENDUM RESULT, AND ITS CONFIRMATION IN SARDINIA, INDICATED CLEARLY THAT THE LONG TERM TREND IN ITALY HAS BEEN AWAY FROM TRADITIONAL PARTY LOYALTIES AND TOWARD POLITICAL JUDGEMENTS BASED ON THE MERITS OF THE ISSUES AT HAND. COMMON ASSUMPTIONS HAVE GENERALLY HELD THAT THE ITALIAN PEOPLE NURTURED GROWING AMBITIONS TO BECOME A FULLY MODERN 20TH CENTRY NATION, BUT THESE ASSUMPTIONS WERE KEPT IN QUESTION BEFORE THE REFERENDUM BY THE TENACITY WITH WHICH THE ELCTORATE HAS CLUNG TO ITS TRADITIONAL PARTIES AND RESPONDED TO TRADITIONAL APPEALS. THERE IS A FEELING IN THE LAND THAT ALL THIS IS CHANGED, AND THAT THE POLITICAL CLASS WILL HAVE TO ASSUME THE ELECTORATE TO BE A PROGRESSIVE AND AWAKENED BODY POLITIC WHICH WILL SUPPORT POLITICAL LEADERS IN ACCORDANCE WITH WHAT THEY DO RATHER THAN IN ACCORDANCE WITHIN PARTY OR CHURCH LOYALTY.

8. ON THE EXTERNAL SIDE, CIRCUMSTANCES HAVE SOMEWHAT SLOWED THE GROWTH OF PROBLEMS BETWEEN ITALY AND THE UNITED STATES. THE GENTLEMEN'S AGREEMENT ON US/EC RELATIONS, THE SIGNING OF THE NEW ATLANTIC DOCUMENT, THE LONG STEPS TOWARD PEACE IN THE MID-EAST AND THE CONSEQUENTLY MORE FAVORABLE CLIMATE FOR EC-ARAB INITIATIVES, THE WITHDRAWAL OF U.S. OBJECTIONS TO THE ITALIAN INITIATIVE FOR A SEPARATE MEDITERRANEAN DECLARATION IN CSCE, AND FINALLY, A CERTAIN MELLOWING OF THE ITALIAN HARD LINE ON BASKET III HAVE ALL HELPED PUSH INTO THE BACKGROUND ANY QUESTION OF POSSIBLE INCOMPATIBILITY BETWEEN ITALY'S COMMITMENTS TO THE EC AND TO CLOSE ATLANTIC RELATIONS.

9. AT THE SAME TIME THE WEAKNESS OF THE GOVERNMENT AND ITS GROWING SENSITIMPTY TO PRESSURES FROM THE LEFT MAY PRESAGE CONTINUING DIFFICULTIES FOR OUR HOME PORTING OPERATIONS IN LA MADDELENA. THESE PRESSURES COULD CONCEIVABLY ALSO ADVERSELY AFFECT OUR MILITARY ACTITIVIES ELSEWHERE IN ITALY.

WHILE WE SEE NO PROBLEMS ON THE HORIZON NOW THAT WE CANNOT MANAGE, WE NOTE THE COMBINATION OF CIRCUMSTANCES, INCLUDING ECONOMIC PRESSURES ON THE DEFENSE BUDGET, WHICH SEEM TO FLOW IN A DIRECTION COMPATIBLE WITH LEFT-WING AMBITIONS FOR AN ITALY SOMEWHAT LESS COMMITTED TO THE NATO-, EC, AND ATLANTIC TIES.

10. CONCLUSIONS WITHOUT DOUBT THE DIMINISHED COHESION OF THE
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PAGE 04 ROME 08866 02 OF 02 262014Z

GOVERNING PARTIES IN ITALY, THE CONTINUING SERIOUSNESS OF THE ECONOMIC SITUATION, AND THE INCREASED PRESSURES ON ITALIAN

INSTITUTIONS T PROVIDE SECURITY, LAW AND ORDER, REFORMS, AND
MATERIAL WELL-BING, CONVERGING AS THEY DO AT THIS TIME, CREATE
A MORE FRAGILE SITUATION WHICH MAGNIFIES THE IMPORTANCE OF THE
BUILT-IN FRICTIONS AND INEFFICIENCIES OF THE ITALIAN SYSTEM
TO WHICH WE HAVE LONG BEEN ACCUSTOMED. THERE IS A GROWING
ACCEPTANCE OF THE NEED FOR CHANGE, BUT LITTLE
EVIDENCE THAT ITALIAN INSTITUTIONS AS THEY ARE STRUCTURED
WILL BE ABLE TO ADAPT TO THE CONCLUSIONS WHICH ARE BEING DRAWN.
WE ACCEPT THE ASSESSMENT MADE INTER-ALIA BY REPUBLICAN LEADER UGO
LA MALFA, THAT THE PRESENT PASTE-TOGETHER OF THE COALITION, AND
THE CCONOMIC ACCORDS WHICH PERMITTED IT, WILL INEVITABLY BE
RIPE FOR CRITICAL REVIEW BY THE SUMMER'S END. VOLPE

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